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Partnerships

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PARTNERSHIPS

by

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THIS year's survey of partnership law contains no extraordinary or startling cases. All in all, it was a relatively moderate year of activity in the area. For the reader's convenience, the authors grouped the cases under topical headings corresponding to the most important partnership law aspect of the case. The reader is once again admonished to consult federal bankruptcy court decisions involving partners and partnerships.[1]

I. PARTNER/PARTNERSHIP RELATIONSHIP

A number of cases during the survey period dealt with aspects of the legal relationships between partners and between a partner and the partner's partnership. The rules governing those relationships make the law of partnerships an interesting challenge.

A. Liability; Mutual Agency

The liability of partners for the debts of the partnership and the ability of a partner to act under circumstances that bind the other partners and the partnership are important and unique. The cases in this section address some of those issues.

1. Hall Dadeland Towers Associates v. Hardeman[2]

In *Hall Dadeland* the court held that a limited partnership had sold securities (limited partnership interests) in violation of Florida's securities registration requirements.[3] Much of the case involved securities brokerage, agency and related issues and has no partnership law relevance.

Procedurally, the partnership, Hall Dadeland Towers Associates, initiated the lawsuit against Hardeman to collect on a promissory note given to purchase the limited partnership interest. Hardeman countersued the plaintiff partnership and joined its general partners as third-party defendants, al-

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1. *See* Waters & Berkley, *Partnerships, Annual Survey of Texas Law*, 44 SW. L.J. 203, 203 n.1 (1990).

2. 736 F. Supp. 1422 (N.D. Tex. 1990).

3. *Id.* at 1436.

leging violations of state securities laws.[4] As a prerequisite to finding liability for securities violations under Florida law, a court must first find that the alleged violator "personally participated" in the transaction.[5] After finding that the partnership satisfied the statutory personal participation prerequisite through the sales activities of its agents, who were securities brokers, the court held in favor of Hardeman.[6]

The court found no personal participation by the individual general partners, but entered judgment against them anyway, citing "black-letter partnership law" and judicial economy.[7] This effectively highlights the essence, from a liability perspective, of being a general partner, as provided in section 15 of the Texas Uniform Partnership Act (TUPA).[8]

2. *Mery v. Universal Savings Association*[9]

Mery primarily involved a lending transaction and the application of the now famous *D'Oench, Duhme* doctrine.[10] The case contains an apparently mistaken analysis of partnership law that requires identification. The relevant non-partnership issues are fairly straightforward. To refinance an ex-

4. *Id.* at 1424.
5. *Id.* at 1436.
6. *Id.*
7. *Id.* The court's view:

> It is thus quite obvious that, as a matter of law, [the third-party defendant general partners] will be jointly and severally liable for the debt resulting from the entry of judgment in this case, notwithstanding the fact that they did not "personally participate" as required by [Florida law]. It does not seem to this Court to be in the interest of judicial economy to enter a judgment which renders only [the partnership] liable, knowing that other entities, by application of black-letter partnership law, will by operation of law immediately be jointly and severally liable upon entry of such a judgment. Thus, it is the Court's opinion that its equitable powers should be exercised so as to extend liability, jointly and severally, to [the individual general partners].

Id. While the case is probably consistent with Cissne v. Robertson, discussed *infra* notes 103-07, because the two general partners were, in fact, properly-served third-party defendants to the lawsuit in this case, the quoted language suggests a slightly different orientation from that of the court in *Cissne*.

8. TEX. REV. CIV. STAT. ANN. art. 6132a (Vernon 1970) [hereinafter TULPA]. The court correctly began with § 10(a) of TULPA, which provides that a general partner of a limited partnership has the same liabilities as a general partner in a general partnership, citing TEXAS UNIFORM PARTNERSHIP ACT § 15 (TEX. REV. CIV. STAT. ANN. art. 6132b (Vernon 1970)) [hereinafter TUPA].

9. 737 F. Supp. 1000 (S.D. Tex. 1990).

10. D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942) stands for the proposition that federal bank examiners are not bound by secret agreements of borrowers that tend to mislead the examiners. The modern extension of the doctrine, which became very highly-developed in this era of bank and savings and loan failures (some of the numerous progeny are listed at 737 F. Supp. at 1004), protects the FDIC, and, therefore, the taxpayers from exposure to losses resulting from numerous types of alleged oral agreements, claims of fraudulent conduct and other matters not authorized by the highest levels of the institution's management and not contained in the lending institution's permanent records. Those records allow bank examiners and deposit insurers to determine relatively quickly the lending institution's financial condition. *D'Oench, Duhme* is a very effective tool in the hands of federal regulators and insurers, as well as successor institutions, in defeating claims of borrowers (as often as not, on summary judgment). The issue of the applicability of the doctrine arises in this case, and federal court jurisdiction lies, because Universal Savings failed three days before the filing of this suit and at the time of the suit Resolution Trust Corporation held the conservatorship.

isting loan, the plaintiffs formed a Texas limited partnership with a third individual, Pinckney[11] (one of the defendants in this case), and executed three separate promissory notes payable to defendant Universal Savings. Several months later, a joint venture composed of the same individuals executed a fourth note, also payable to Universal. Pinckney arranged for the financing evidenced by the four notes.

Among other claims, plaintiffs Mery and Karam alleged that Pinckney conspired with Universal to defraud them with respect to the loan transactions. Universal, through the Resolution Trust Corporation, raised in defense the *D'Oench, Duhme* doctrine.[12] The court concluded that the *D'Oench, Duhme* doctrine protected Universal from the plaintiffs' claims.[13] Pinckney's alleged conspiracies with Universal were, by definition, "secret side agreements" because the plaintiffs were not aware of them.[14] Unfortunately for the plaintiff partners, the court found that the agreements were made on behalf of the partnership, and thus the plaintiff partners could not avoid application of the *D'Oench, Duhme* doctrine.[15] The court's statement of the state partnership law rule producing this result is very puzzling: "It is a fundamental principle of agency and partnership law that all partners of a *limited partnership* are jointly and severally liable for a partner's wrongful acts and breaches of trust."[16] The court cites section 15 of the Texas Uniform Limited Partnership Act (TULPA)[17] in support of this proposition. That section has nothing to do with the stated principle.[18] On the other hand, section 15 of TUPA, the key statutory liability provision of partnership law, provides that partners have joint and several liability for the partnership's obligations.[19] This is undoubtedly the provision the court had in mind.[20]

Almost as surprising as its statement regarding the liability of a limited partner, the court also stated that "once a Limited Partnership has given

11. A review of partnership filings with the Secretary of State's Office, discussed in detail *infra* notes 22, 23, and the Cissne v. Robinson case, discussed *infra* notes 103-07, suggest that the correct spelling of the defendant's name is "Pinckney," even though the spelling in this opinion is "Pickney." The former spelling will be used in this discussion.

12. 737 F. Supp. at 1002.

13. *Id.* at 1003.

14. *Id.*

15. *Id.*

16. *Id.* (emphasis added).

17. TEX. REV. CIV. STAT. ANN. art. 6132a, § 15 (Vernon 1970).

18. TULPA § 15 deals with priority among the limited partners of a limited partnership.

19. TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (Vernon 1970).

20. Joint and several liability for the partnership includes the obligations under §§ 13 and 14 of TUPA. TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 13, 14 (Vernon 1970). Section 13 is entitled "Partnership Bound by Partner's Wrongful Act" and § 14 is entitled "Partnership Bound By Partner's Breach of Trust." TUPA § 15 is certainly applicable to the general partners of a limited partnership, pursuant to TUPA § 6(2), which makes TUPA applicable to limited partnerships to the extent not inconsistent with TULPA. *Id.* §§ 6(2), 15. The plaintiffs might have argued for the applicability of TUPA § 12, which excepts from the general rule that a partnership is charged with knowledge of or notice of facts relating to partnership affairs acquired by any one partner, "a fraud on the partnership committed by or with the consent of that partner." *Id.* § 12. The federal defense supplied by the *D'Oench, Duhme* doctrine would, however, almost certainly have preempted the state law rule. *See supra* note 10.

actual or apparent authority *to the limited partner*, a bank cannot be required to act as 'referee' for the partnership."[21] It would be unusual for a partnership to give authority to a limited partner, rather than a general partner.[22] Further, the facts do not seem to show that this occurred here.[23]

To conclude that the court missed the mark on these points is not difficult. Before obtaining and reviewing the Certificate and Agreement of limited partnership,[24] the authors speculated that perhaps the court was sloppy in its citations or omitted from the opinion key facts that somehow would have better supported its statements. Neither appears to be the case. The best explanation may be that the federal law of *D'Oench, Duhme* preempts the state law.[25]

B. Dissolution: Option of Noncontinuing Partner

Perhaps one of the most important and lesser known rules of partnership law is the payment option available to a partner who separates from a partnership that continues its business after dissolution. This option is the more important of the two partnership issues discussed in the next case.

In *King v. Evans*[26] the San Antonio court of appeals examined two partnership issues: 1) when is property acquired by one partner in its own name considered to be partnership property; and 2) after dissolution and for purposes of payment to a retiring partner, how and when is the noncontinuing former partner's interest in a partnership valued? In *King* the noncontinuing partner sued the continuing partner to recover the value of the former's interest in the partnership. The primary asset of the partnership was a 725-acre tract of land. The jury found in favor of the noncontinuing partner.[27] The trial court awarded the former partner one-half of the net cash value of

21. 737 F. Supp. at 1004 (emphasis added).

22. By statute, limited partners do not become liable as general partners unless they take part in the control of the partnership's business. TEX. REV. CIV. STAT. ANN. art. 6132a, § 8 (Vernon Supp. 1991). Their traditional role has therefore been very passive. The limited partner's role was passive here, as well, at least by contract, although the court's opinion obviously suggests the contrary. The Certificate and Agreement of Limited Partnership of Valley Plaza Partners, Ltd., filed with the Secretary of State of Texas for the partnership in this case on March 1, 1985 to satisfy TULPA § 3 (and obtained by the authors from the Secretary of State), does not support the court's statement. *Id.* § 3 (Vernon 1970 & Vernon Supp. 1991). The Certificate shows Pinckney, Karam, Mery and First Universal Service Corp. as the general partners, and First Universal Service Corp. as the limited partner. The limited partnership did not file any amendments that would have altered its structure. Section 3.04 of the Certificate and Agreement expressly disabled the limited partner from taking part in the management or control of the partnership or from transacting business in its name. From this, it appears that Pinckney orchestrated execution of the four notes as a general partner. Even so, his authority to act without the other general partners is not given by the Certificate and Agreement which, in Article III, requires joint action by all general partners.

23. The only clue from the opinion is the court's statement that Pinckney "was previously associated with the plaintiffs as a limited partner." 737 F. Supp. at 1001. That statement is expressly contradicted by the Certificate and Agreement, as described *supra* note 22.

24. *See supra* notes 22, 23.

25. *See supra* note 10 (discussing *D'Oench, Duhme* doctrine). In many, if not most, situations where the doctrine is raised, the borrowers simply lose.

26. 791 S.W.2d 531 (Tex. App.—San Antonio 1990, writ denied).

27. *Id.* at 532.

the partnership at the date of dissolution, plus pre-judgment and post-judgment interest, attorney's fees and costs.[28]

The continuing partner appealed, first challenging the trial court's holding that the land was a partnership asset.[29] The special issues answered affirmatively by the jury included the following: 1) the partners agreed to form a partnership; 2) the partnership agreement was entered into before the continuing partner received title to the property; and 3) the partners agreed that the farming partnership would include ownership of the land.[30] In other words, the jury found, as a matter of fact, that the parties operated as a partnership and that the land was an asset of their partnership.

The court rejected the continuing partner's argument that property can be owned by a partnership only if it is purchased with partnership property.[31] The court relied in part on TUPA section 8(1), which provides that "*All property* originally brought into the partnership stock or subsequently *acquired by purchase* or otherwise, *on account of the partnership, is partnership property.*"[32] The court also noted with approval prior case law holding that a deed to land taken in only one partner's name is not conclusive in determining ownership of the asset.[33] Whether the partnership owns property used in a partnership operation is simply a question of intent.[34] Thus, the court found that the trial court justifiably concluded from the jury's responses to the special issues that, although legal title rested in the name of one of the partners, equitable title remained with the partnership, and the land was correctly considered a partnership asset.[35]

The court of appeals then analyzed whether the judgment awarded by the trial court rested on an accurate valuation of the noncontinuing partner's interest in the partnership. The court accurately stated that if a partnership is not wound up after dissolution, but is continued, with or without agreement, then the noncontinuing partner may elect between one of two alternatives.[36] First, in the absence of a contrary agreement,[37] the former partner may force a liquidation, take his share of the proceeds, and thereby share in the profits and losses after dissolution (that is, during the time between dissolution and liquidation).[38] Alternatively, the noncontinuing partner may

28. *Id.*

29. *Id.* Based on the jury's responses to several special issues, the trial court concluded that the land was acquired on behalf of the partnership as partnership property.

30. *Id.*

31. *Id.* at 533.

32. *Id.* (quoting TEX. REV. CIV. STAT. ANN. art. 6132b, § 8(1) (Vernon 1970)) (emphasis in original).

33. 791 S.W. 2d at 533 (citing Logan v. Logan, 138 Tex. 40, 48, 156 S.W.2d 507, 512 (1941)); *see also* TEX. REV. CIV. STAT. ANN. art. 6132b, § 10 (Vernon 1970).

34. 791 S.W.2d at 533 (citing *Logan*, 138 Tex. at 48, 156 S.W.2d at 512).

35. 791 S.W.2d at 533 (citing Miller v. Howell, 234 S.W.2d 925, 929 (Tex. Civ. App.—Fort Worth 1950, no writ)).

36. 791 S.W.2d at 535.

37. TEX. REV. CIV. STAT. ANN. art 6132b, § 38(1) (Vernon 1970) (granting liquidation right "unless otherwise agreed.").

38. *Id.* The court erroneously cited to TUPA § 42 for this proposition. 791 S.W.2d at 535.

permit the business to continue and claim as a creditor the value of the partner's interest in the partnership at dissolution.[39] If the noncontinuing partner selects the second alternative, the partner has to further decide between receiving either interest or profits from the date of dissolution of the value at dissolution of the partner's interest.[40]

The court noted that the purpose of TUPA section 42 is not only to afford a noncontinuing partner the benefit of asset appreciation that occurred up to the time of dissolution, but also to protect the partner from post-dissolution losses.[41] Therefore, the court upheld the trial court's conclusion that because the business continued after the dissolution of the partnership, without any settlement of accounts,[42] the noncontinuing partner was entitled to receive the value of his partnership interest at the time of dissolution, plus either interest or profits accrued after the date of dissolution.[43] Because there were no profits attributable to the business after dissolution, the retiring partner naturally chose to receive interest.

King demonstrates clearly the risk that partners run if they do not know the law well enough to protect themselves. Being aware of TUPA section 42 might at least encourage some partners to promptly settle accounts. Because section 42 allows a retiring partner the option of choosing profits if the business is successful after dissolution, or settling for value at dissolution, plus interest, if the business is unsuccessful after dissolution, those partners who are not well-versed in partnership law may find, to their dismay, that a retiring partner is entitled to more money than they originally anticipated.[44]

C. Aggregate of Individuals or an Entity?

Although TUPA represents a clear victory for those who believe that a partnership should be considered a separate entity rather than an aggregate of individuals, elements of the aggregate theory remain entrenched in the law.[45]

In *Lawler v. Dallas Statler-Hilton Joint Venture*[46] the Dallas court of appeals upheld the trial court's summary judgment that an individual partner in a partnership or joint venture is an employer of the partnership's or venture's employees,[47] for purposes of the Texas Workers' Compensation Act.[48] As a result, the court held the partner immune from a personal injury suit

39. TEX. REV. CIV. STAT. ANN. art. 6132b, § 42 (Vernon 1970).
40. *Id.*
41. 791 S.W.2d at 535 (citing CRANE & BROMBERG, PARTNERSHIP 496-97 (1968)).
42. The TUPA § 42 option is available to a retiring partner only if there is not a settlement of accounts. TEX. REV. CIV. STAT. ANN. art. 6132b, § 42 (Vernon 1970).
43. 791 S.W.2d at 535.
44. TEX. REV. CIV. STAT. ANN art. 6132b, § 42 (Vernon 1970).
45. *See* Bromberg, *Source and Comments*, TEX. REV. CIV. STAT. ANN. art. 6132b, § 1 (Vernon 1970).
46. 793 S.W.2d 27 (Tex. App.—Dallas 1990, writ denied).
47. *Id.* at 34.
48. Act of March 29, 1917, 35th Leg., R.S., ch. 103, 1917 Tex. Gen. Laws 269, *repealed by* Acts of 1989, 71st Leg., 2nd C.S., ch. 1, § 16.01(7)-(9), 1989 Tex. Sess. Law Serv. 114 (Vernon) (effective January 1, 1991).

brought by an employee who previously recovered for the same injury under Texas workers' compensation laws.[49] The court's holding was consistent with earlier Texas decisions involving the issue of whether a partner was an employee for purposes of bringing a workers' compensation suit against the partnership.[50] The court believed, however, that the issue of whether the partner was an "employer" for workers' compensation purposes when the partner is named a defendant was one of first impression.[51] In reaching its decision, the court followed the rule adopted by a majority of other states that have considered the issue.[52]

The Texas Workers' Compensation Act limits an employee to an exclusive remedy against an employer, who subscribes to the Act's coverage, for injuries incurred by the employee in the course of employment.[53] In exchange, and at the expense of forfeiting substantial defenses, the subscribing employer is protected from having to defend numerous lawsuits brought by its employees.[54] Thus, because Lawler had already recovered under the workers' compensation statute, the law precluded her from again suing her employer. The key issue remained as to whether the individual partner was her employer.

The court acknowledged that, since the adoption of TUPA, Texas has followed the entity theory of partnerships for most purposes, including procedural issues,[55] but noted that there are also many aggregate features to the Act.[56] In this case, the court essentially applied the aggregate theory to the employment relationship, and held that in cases involving claims by employees of a partnership employer, the individual partners or joint venturers are, as a matter of law, also employers of the partnership's or joint venture's employees.[57] The court concluded that this holding was consistent with the theory and practice of workers' compensation law and with the clear legislative intent of making a statutory workers' compensation claim an exclusive remedy.[58] This case, by invoking the aggregate theory, represents an exception to the general rule which views partnerships as separate entities.

II. CHARACTERIZATION OF PARTNERSHIP INTEREST

A. Is it a Security?

The sale of a partnership interest can indeed be considered the sale of a

49. 793 S.W.2d at 34.
50. *Id.* at 31 (citing Powell v. Vigilant Ins. Co., 577 S.W.2d 364, 366 (Tex. Civ. App.—Tyler 1979, no writ) (partner not employee for this purpose)).
51. 793 S.W.2d at 31.
52. *Id.* at 31-32.
53. Act of March 29, 1917, 35th Leg., R.S. ch. 103, 1917 Tex. Gen. Laws 269 (repealed 1989).
54. 793 S.W.2d at 31 (citing Paradissis v. Royal Indemn. Co., 507 S.W.2d 526, 529 (Tex. 1974)).
55. *See* Bromberg, *Source and Comments*, TEX. REV. CIV. STAT. ANN. art. 6132b, § 1 (Vernon 1970).
56. 793 S.W.2d at 33-34.
57. *Id.* at 34.
58. *Id.*

security. As such, those individuals buying and selling partnership interests need to be familiar with both state and federal securities law.

In *L & B Hospital Ventures, Inc. v. Healthcare International, Inc.*[59] the Fifth Circuit considered whether, under the facts of the case, a limited partner's interest in a partnership was an investment contract subject to the protections afforded by the Securities Exchange Act of 1934.[60] The key issue was whether the limited partners were dependent on the general partner to run the partnership because of the general partner's specialized knowledge or expertise.[61] The court framed the issue by citing with approval from Judge King's "lengthy and thoughtful"[62] opinion in *Williamson v. Tucker*:[63] "A partnership can be an investment contract only when the partners are so dependent on a particular manager that they cannot replace him or otherwise exercise ultimate control."[64]

In *L & B Hospital Ventures, Inc.* the plaintiffs, three psychiatrists and a medical corporation, sold their limited partnership interests in a psychiatric institute venture to the general partner of that partnership. After the sale, the plaintiffs discovered certain previously undisclosed facts upon which they based their suit for fraud and deception. The trial court granted the defendants' motion for summary judgment, accepting defendants' assertion that the plaintiffs/limited partners' active participation in the business precluded a securities law violation because the partnership interest sold and purchased was not a security.[65] The trial court emphasized that the plaintiffs' active involvement in the hospital and their contribution to its profitability were crucial to the hospital's success, but overlooked or minimized the essential role of an operational manager, such as the general partner.[66]

After thoroughly reviewing the fact witnesses' testimony, the court of appeals determined that the plaintiffs did not have managerial control, even though they did exercise some professional or clinical control.[67] Consequently, the court reversed the summary judgment of the trial court, on the basis that *"efforts made by those other than the [limited partners were] undeniably significant ones, [comprised of] essential managerial efforts which affected the failure or success of the enterprise."*[68] The court concluded that

59. 894 F.2d 150 (5th Cir. 1990), *reh'g denied*, 901 F.2d. 1110 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 55 (1990).

60. 15 U.S.C. § 78t(a) (1983). As the court acknowledged, generally a limited partner's interest is an investment contract. 894 F.2d at 151 (citing Williamson v. Tucker, 645 F.2d 404 (5th Cir. 1981), *cert. denied*, 454 U.S. 897 (1981)).

61. 894 F.2d at 152.

62. *Id.*

63. 645 F.2d 404, 424.

64. *Id.*

65. 894 F.2d at 152. As discussed *supra* note 60, a security will not be found in this context without a finding that the purchaser relied on the efforts of others to make the investment profitable.

66. *Id.*

67. *Id.*

68. *Id.* (emphasis in original) (citing Williamson v. Tucker, 645 F.2d 404, 418 (quoting with approval Securities Exchange Commission v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 (9th Cir. 1973), *cert. denied*, 414 U.S. 821 (1973))).

summary judgment relief was improper because a material fact issue existed on where managerial control resided.[69]

The issue of whether a partnership interest is a security, the sale of which is subject to applicable securities laws, may increase in significance in an era where limited partnership statutes give greater management rights to limited partners.[70] While the sale of limited partnership interests to traditionally passive limited partners involves the sale of a security, the same may not be true when the limited partner actively participates in management of the partnership or its business.

B. Owners of a Partnership Interest are Not Necessarily Partners

One of the most frequent misconceptions of partnership law is that the owner of a partnership interest is always a partner. That is often not true, as the following cases indicate.

1. Griffin v. Box[71]

The primary partnership issue in *Griffin*, which procedurally was an interlocutory appeal of a temporary injunction,[72] was whether transferees of depositary receipts, evidencing ownership of units of limited partnership and distributed to former shareholders on the conversion of a corporation to a limited partnership, automatically became substituted limited partners under the terms of the partnership agreement and under Texas law.

In *Griffin* the limited partners asserted that all transferees, as well as the initial unit holders of the depositary receipts,[73] were entitled to become and, in fact, had been admitted as limited partners in the partnership, based upon the language of both the partnership agreement and the depositary agreement. Specifically, the depositary agreement provided that: 1) the depositary receipts were transferable; 2) the transferor gave the transferee the right to become a substituted limited partner in the partnership, subject to the provisions of the partnership agreement; 3) by accepting a receipt, a transferee became a party to the depositary agreement and agreed to be bound by its terms; and 4) as provided in the partnership agreement, a transferee, pending his admission as a substituted limited partner, had the rights of an assignee with respect to the partnership units.[74]

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69. 894 F.2d at 153.

70. *E.g.*, TEX. REV. CIV. STAT. ANN. art. 6132a-1, § 3.03(b) (Vernon Supp. 1991); *accord* DEL. CODE ANN. tit. 6, § 17-303(b) (1988).

71. 910 F.2d 255 (5th Cir. 1990).

72. The trial court granted and denied in part both parties' motions for preliminary injunctions. The key issue was the identity of the general partner, each party asserting a different person favorable to it. *Id.* at 258-59.

73. There was no dispute about the status as limited partners of the initial group. *Id.* at 259.

74. *Id.* at 260 (emphasis added). Perhaps because of the procedural posture of the case, the court did very little to explain that one who owns a partnership interest is not necessarily a partner. A non-partner owner of a partnership interest is usually an assignee who, typically, owns most or all economic rights attributable to the interest, but not voting or other management rights. *E.g.*, TEX. REV. CIV. STAT. ANN. art. 6132a, § 20 (Vernon 1970) (partnership

The court concluded that, as a matter of contract, the depositary agreement, which standing alone the court acknowledged could almost be read to provide for automatic admission,[75] was made subject to the partnership agreement. The partnership agreement gave the general partners the discretion to admit transferees as limited partners.[76] Therefore, no unilateral or automatic right to become a substituted limited partner existed.

The second issue was whether the general partner owed a fiduciary duty to a non-partner transferee. The transferees alleged that the general partners owed them a fiduciary duty and a duty of good faith and fair dealing, which required them to admit all eligible transferees as substituted limited partners. The court, however, said that the general partners owed no fiduciary duty to transferees who were not partners.[77] Furthermore, the court found inadequate evidence to conclude that the general partners occupied any other special relationship with any particular transferee that gave rise to a fiduciary duty.[78] The court rejected the transferees' claim that the general partners approved the transferees' admission.[79] The court rejected the claim despite evidence that the general partners represented in proxy statements that the depositary receipt holders would be entitled to vote and that the transferees were, in fact, permitted to vote at a partnership meeting without having formally been admitted as substituted limited partners.[80] The court acknowledged that the general partner apparently admitted some transferees, directly or by estoppel, but found insufficient evidence to conclude that the general partners admitted any particular group, so as to thereby validate the votes they had cast for "their" general partner candidate.[81]

2. *Friedman v. New Westbury Village Associates*[82]

While the limited facts make it difficult to accurately evaluate the court's conclusions, a full treatment of the facts as they are given in the opinion is necessary to discuss this case. Plaintiff, Susanna Friedman, became the owner of a seven percent joint venture interest in the defendant joint venture, as part of a divorce settlement with her husband. Her husband was left with a five and one-half percent interest. The joint venture agreement contained a capital call provision obligating each venturer to contribute his or her pro rata share of cash funds necessary to conduct the business of the joint venture. The agreement expressly included principal and interest due on prom-

interest in limited partnership context); TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 24-27 (Vernon 1970) (general partner's interests). Also, see the *Friedman* discussion, *infra* notes 82-96.

75. TEX. REV. CIV. STAT. ANN. art. 6132a, § 20(d) (Vernon 1970) provides statutory support for this proposition. An assignee can become a limited partner if the certificate of limited partnership allows the assignor to, and the assignor does, give the assignee that right.

76. 910 F.2d at 260.

77. *Id.*

78. *Id.*

79. *Id.* at 262.

80. *Id.*

81. *Id.* at 262-63.

82. 787 S.W.2d 154 (Tex. App.—Houston [1st Dist.] 1990, no writ).

issory notes executed by the venture in connection with the ownership and operation of an apartment project. Failure of a venturer to pay his or her share entitled the other venturers to advance the necessary funds and receive a lien against the joint venture interest of the defaulting venturer, obligating the defaulting venturer to repay 125% of the amount advanced, plus interest. Failure to repay within six months after default caused the non-paying venturer to forfeit his or her interest proportionately to the paying venturers.

The venture agreement further provided for determination of matters of policy by a vote of seventy percent in interest of the venturers. The agreement obligated each venture partner to personally execute promissory notes evidencing interim financing. The financing was to be used both for constructing improvements and for permanent mortgages, but without personal liability for the latter. The co-managers of the venture, Samet and Mr. Friedman, were expressly prohibited, however, from mortgaging the project or from borrowing money unless they first obtained a vote of at least 70% in interest of the venturers.

The divorce agreement between the Friedmans obligated each of them, as transferee, to assume and pay the debts, encumbrances and liens proportionately to the extent that each received property from the other spouse. Mrs. Friedman was not, however, responsible for personal guarantees signed by Mr. Friedman, "*except* as to [her] *pro rata share* by reason of her interest *in the properties listed on Schedule I, Item 15, and as contained in the respective Partnership or Joint Venture Agreements.*"[83]

Sometime later, Mrs. Friedman, and several of the venturers, signed a document authorizing the manager of the joint venture to execute a $50,000 promissory note on behalf of the venture. Fifteen months later, a $300,000 note was executed, identifying Ben Friedman as the maker and signed by Ben Friedman, as trustee. Samet apparently testified that Mr. Friedman signed the note on behalf of the venture to borrow money to renovate the venture's project.[84] The note stated the collateral to be the "continuing guarantee of the partners."[85] Only six weeks later, the lien against the apartment project was foreclosed and the sales proceeds applied to reduce the balance of the $300,000 note. The venturers received a cash call for contributions needed to pay the balance, and all venturers paid their shares except for the Friedmans. Approximately a year later, the venture made demand on the Friedmans to pay to the venture their share of the amounts remaining due on the $300,000 loan, plus certain other items that apparently had not been previously paid.[86]

Mrs. Friedman attempted to avoid liability by asserting three arguments: 1) the divorce settlement agreement was ambiguous on whether she was lia-

83. *Id.* (emphasis in original); *see infra* note 90 for a discussion of the quoted language.
84. *Id.* at 157.
85. *Id.*
86. *Id.* The court stated that Mrs. Friedman owed money for prior cash calls, as well as the cash call on the $300,000 note, but stated two paragraphs later that Mr. Samet testified that Mrs. Friedman attended meetings of the joint venture and paid when previous cash calls were made. *Id.*

ble for debts arising from ownership of property awarded to her; 2) that a note executed as part of the settlement of the deficiency on the $300,000 note had not been approved by the requisite owners of 70% of the percentage interests of the venturers required to approve a matter of policy; and 3) her interest in the joint venture had been automatically forfeited after she failed to pay within six months of her default, excusing her from further liability.[87]

In response to Mrs. Friedman's assertion that she was not liable because she had not signed the joint venture agreement or the $300,000 note, the court referred to TUPA section 28-B(1)(A),[88] which provides that on the divorce of a partner the spouse is, to the extent of the spouse's interest in the venture, regarded as an assignee or purchaser of the interest from the partner.[89] That reference seems completely unnecessary given that the written property settlement agreement clearly awarded her the seven percent venture interest. The court further found the settlement agreement unambiguous on the issue of her liability for debts incurred on the property awarded to her, including the seven percent joint venture interest.[90] Mrs. Friedman also argued that she was not liable for the joint venture's debts, presumably based on a claim that, because she had not signed the joint venture agreement, she was not a partner.[91] In addition to the divorce settlement agreement awarding her the partnership interest, to which the court arguably gave too much significance, the court found ample evidence of partnership by estoppel under TUPA section 16.[92]

Based on the facts given in the opinion, it would seem that Mrs. Friedman had a much stronger argument that the $300,000 note was not within the scope of the expressly authorized financing and, therefore, required a 70% affirmative approval. Her apparent failure to push that position, confirmed by the court,[93] suggests that she believed that the debt had in fact been authorized.

The court had little difficulty in concluding that Mrs. Friedman could not

87. 787 S.W.2d at 158. It is revealing that Mrs. Friedman apparently did not argue that the $300,000 note had been improperly executed for lack of the requisite seventy percent vote.

88. TEX. REV. CIV. STAT. ANN. art. 6132b § 28-B(1)(A) (Vernon 1970).

89. 787 S.W.2d at 158.

90. *Id.* The issue of ambiguity is debatable if based solely on the language from the settlement agreement quoted in the text *supra* note 83 and discussed *infra* note 91. The court did not refer to TUPA § 17, which effectively provides that a newly-admitted partner is liable for existing partnership debts only to the extent of the partner's interest in partnership property. TEX. REV. CIV. STAT. ANN. art 6132b, § 17 (Vernon 1970). The settlement agreement language quoted in the text *supra* note 83 is similar in import.

91. TEX. REV. CIV. STAT. ANN. art. 6132b, § 16 (Vernon 1970). There is certainly a legal difference between an assignee of a partnership interest and a partner. *See id.* §§ 24-27, also discussed in Griffin v. Box, *supra* note 74. Apparently without realizing this distinction, this court paraphrased TUPA § 28-B(1)(A) and treated the divorced spouse of a partner as an assignee of the transferred interest. TEX. REV. CIV. STAT ANN. art. 6132b § 28-B(1)(A) (Vernon 1970); *see* discussion in the text, *supra* note 89. Assignees do not have the same liability as partners; absent agreement, assignees cannot participate in management and are simply entitled to receive the assigning partner's share of profits. *See* TEX. REV. CIV. STAT. ANN. art. 6132b, § 27 (Vernon 1970).

92. 787 S.W.2d at 158.

93. *Id.* at 158-59.

benefit from her own default by being thereafter relieved of liability for joint venture indebtedness.[94] Mrs. Friedman urged as support for her position a case in which the remaining joint venturers sought to enforce a forfeiture provision;[95] the case cited, however, was clearly distinguishable from her situation. In each case, the court precluded a defaulting partner from benefiting from the default.[96]

III. PROCEDURAL ISSUES

A. Accounting Prerequisite to Lawsuit Between Partners

The next case is a reminder, both of the rule (which the authors believe to be unknown to many practitioners), and the exception to it, which requires an accounting as a prerequisite to lawsuits between partners.

In *Kartalis v. Lakeland Plaza Joint Venture*[97] the Dallas court of appeals followed its earlier 1989 holding that there is a recognized exception to the general rule that one partner may not sue another partner on matters arising out of partnership business unless an accounting to settle all financial matters between the partners is first performed.[98] The established exception allows one joint venturer or partner to sue another without first having an accounting, if the matter is so simple and free from complexity that it can be readily resolved.[99]

In this case, the joint venture sued Kartalis to recover his pro rata share of operational costs and cash calls claimed to be due pursuant to a joint venture agreement. The joint venture agreement required each venturer to pay advanced estimated costs when the cash flow of the venture was insufficient to satisfy those projected costs. The court explained that this case fell within the "free from complexity" rule because it involved only a few simple transactions, in which the expenses were essentially fixed.[100] Therefore, an accounting was unnecessary.[101] Even if an accounting had been necessary in this case, the financial statements, detailed assessment notices and tax returns, which the joint venture regularly provided to Kartalis, persuaded the court that the joint venture had effectively provided an accounting.[102] This

94. The terms of the joint venture agreement could, of course, have provided for relief from liability.

95. 787 S.W.2d at 159 (citing Shindler v. Harris, 673 S.W.2d 600, 607, 609 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.)).

96. 787 S.W.2d at 159.

97. 784 S.W.2d 64 (Tex. App.—Dallas 1989, writ denied).

98. *Id.* at 66 (citing Chipley v. Smith, 292 S.W. 209 (Tex. Comm'n App. 1927, opinion adopted)). Note that the earlier 1989 case, cited *infra* note 99, coincidentally also involved Kartalis and was reported in last year's survey. It is the authors' experience that the general rule requiring an accounting is not widely known by practitioners and may result in premature litigation.

99. 784 S.W.2d at 66; *see* Kartalis v. Commander Warehouse Joint Venture, 773 S.W.2d 393 (Tex. App.—Dallas 1989, no writ). A joint venture is generally governed by the same principles of law that apply to partnerships. *See* Truly v. Austin, 744 S.W.2d 934, 937 (Tex. 1988).

100. 784 S.W.2d at 66.

101. *Id.*

102. *Id.*

exception to the well-settled partnership principle, that an accounting of all financial matters of a joint venture is a condition precedent to the maintenance of a lawsuit between joint venturers, may hereafter be known as the Kartalis Exception.

B. Partners As Necessary Party Defendants

Even though general partners have joint and several liability for their partnership's debts, properly and timely naming general partners as defendants can be procedurally crucial to maintaining that liability.

1. Cissne v. Robertson[103]

Cissne involved a suit by a real estate broker and salesman[104] to recover a real estate commission against three partners.[105] In addition to the numerous procedural complications, including summary judgments, non-suits, a partner's bankruptcy, and a bench trial granted on motion for new trial,[106] the case involved various provisions of the Texas Real Estate License Act.

The main partnership issue in *Cissne* was the effect on the liability of a partner of a judgment taken against the partner's partnership. In upholding the trial court's decision granting judgment in favor of the partner defendants, the court of appeals stated that where a judgment is taken against a partnership and not against the individual partners, judgment against the individual partners is not presumed.[107] The service of citation rules of the Texas Civil Practice & Remedies Code, not cited by the court, also support this result.[108] This can be a conceptually difficult area for practitioners who do not practice regularly in partnership law matters.

2. Cothrum Drilling Company v. Partee[109]

In *Cothrum* the court of appeals held that the trial court had erred in rendering judgment against individual partners of a partnership not individually served with citation before the statute of limitations ran on the cause of action.[110] The lower court had entered judgment against the partnership

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103. 782 S.W.2d 912 (Tex. App.—Dallas 1989, writ denied).

104. Although brokers and salesmen perform the same role in a real estate transaction, a broker must satisfy a higher statutory standard; therefore, a real estate salesman must have a sponsoring broker. TEX. REV. CIV. STAT. ANN. art. 6573a (Vernon Supp. 1991) (Texas Real Estate License Act).

105. Interestingly, this case also involved Messrs. Mery, Karam and Pinckney, parties in Mery v. Universal Sav. Assoc., discussed in text beginning *supra* note 9.

106. 782 S.W.2d at 915.

107. *Id.* at 927 (citing Mallory v. Russell, 242 S.W. 1112, 1113 (Tex. Civ. App.—Ft. Worth 1922, writ dism'd)).

108. Texas Civil Practice and Remedies Code § 17.022, entitled "Service on Partnership," reads: "Citation served on one member of a partnership authorizes a judgment against the partnership *and the partner actually served.*" TEX. CIV. PRAC. & REM. CODE § 17.022 (Vernon 1986) (emphasis added).

109. 790 S.W.2d 796 (Tex. App.—Eastland 1990, writ denied).

110. *Id.* at 800. As support the court cited § 17.022 of the Civil Practice and Remedies Code, quoted *supra* note 108.

and, jointly and severally, against the individual partners.[111] Although one could logically argue that a timely filing and serving of the partnership should toll the statute of limitations as to individual partners, who will, by law, be jointly and severally liable if liability is found against the partnership,[112] that apparently is not the law in Texas.[113]

IV. FREEDOM TO CONTRACT IS NOT ABSOLUTE

The Texas Supreme Court has made it clear that wide latitude is given to partners in structuring their agreements.[114] That freedom is not unfettered, at least as to non-partnership law issues.

Phillips v. Phillips[115] involved a suit by a limited partner against the general partner for breach of the limited partnership agreement. The subject partnership agreement contained a provision entitling the limited partner to recover from the general partner ten times her actual damages under certain circumstances.[116]

Procedurally, the court decided the case on motion for rehearing, each party having filed one. The limited partner argued that the court erred in not reforming its judgment in her favor to allow the multiplier provided for in the partnership agreement. As support for the argument, the limited partner cited a case that held that where the parties agreed on certain damages, the court would enforce the agreement unless the defendant pled and proved that the provision for liquidated damages was in fact a penalty.[117] The court rejected this rule and cited *Stewart v. Basey*[118] in support of its holding that, as a matter of law, the partnership agreement provision called for a penalty.[119] The court did not agree that the defendant could waive the penalty defense by failing to plead it as an affirmative defense, holding instead that the provision, on its face and as a matter of law, provided "for a penalty in the nature of punitive damages, as distinguished from liquidated compensa-

111. 790 S.W.2d at 797 n.2.

112. *See* TEX. REV. CIV. STAT. ANN. art. 6132b, § 15 (Vernon 1970) (general partners jointly and severally liable for partnership's debts).

113. 790 S.W.2d at 800 (citing Wooster v. Hoecker, 195 S.W. 332, 335 (Tex. Civ. App.—Galveston 1917, no writ)).

114. In Park Cities Corp. v. Byrd, 534 S.W.2d 668 (Tex. 1976), the court said:

> The agreement of the parties is to be controlling of our decision and we shall construe and interpret their agreement pursuant to the applicable law of contracts. We look to the Texas Uniform Partnership Act for guidance only when the partnership agreement is silent. In this case we shall often consider it only as an interpretive aid.

Id. at 672 (citation omitted).

115. 792 S.W.2d 269 (Tex. App.—Tyler 1990, writ granted).

116. Section 16.2 of the partnership agreement reads as follows: "16.2 *Damages.* If the general partner breaches his trust hereunder, he shall pay to the limited partner as liquidated damages ten times the amount she loses as a result of such breach. Errors of judgment shall not be considered breaches of trusts." *Id.* at 272 n.2.

117. *Id.* at 270 (citing Robinson v. Granite Equip. Leasing Corp., 553 S.W.2d 633, 637 (Tex. Civ. App.—Houston [1st Dist.] 1977, writ ref'd n.r.e.)).

118. 150 Tex. 666, 245 S.W.2d 484 (1952).

119. 792 S.W.2d at 272.

tory damages."[120] The court underscored the plead and prove rule of *Robinson*,[121] implying that there the issue was one of fact and here it was a matter of law. As much as partner relationships in Texas are a matter of contract between the partners,[122] the "right of competent parties *to make their own bargains is not unlimited.*"[123]

120. *Id.*
121. *Id.* at 270 (citing *Robinson*, 553 S.W.2d at 637).
122. *E.g.*, Park Cities Corp. v. Byrd; *see* discussion *supra* note 114.
123. 792 S.W.2d at 270 (quoting Stewart v. Basey, 245 S.W.2d at 486 (emphasis in original)).